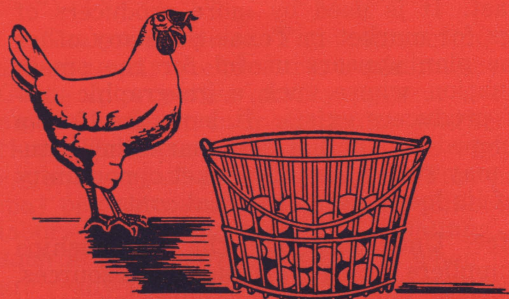


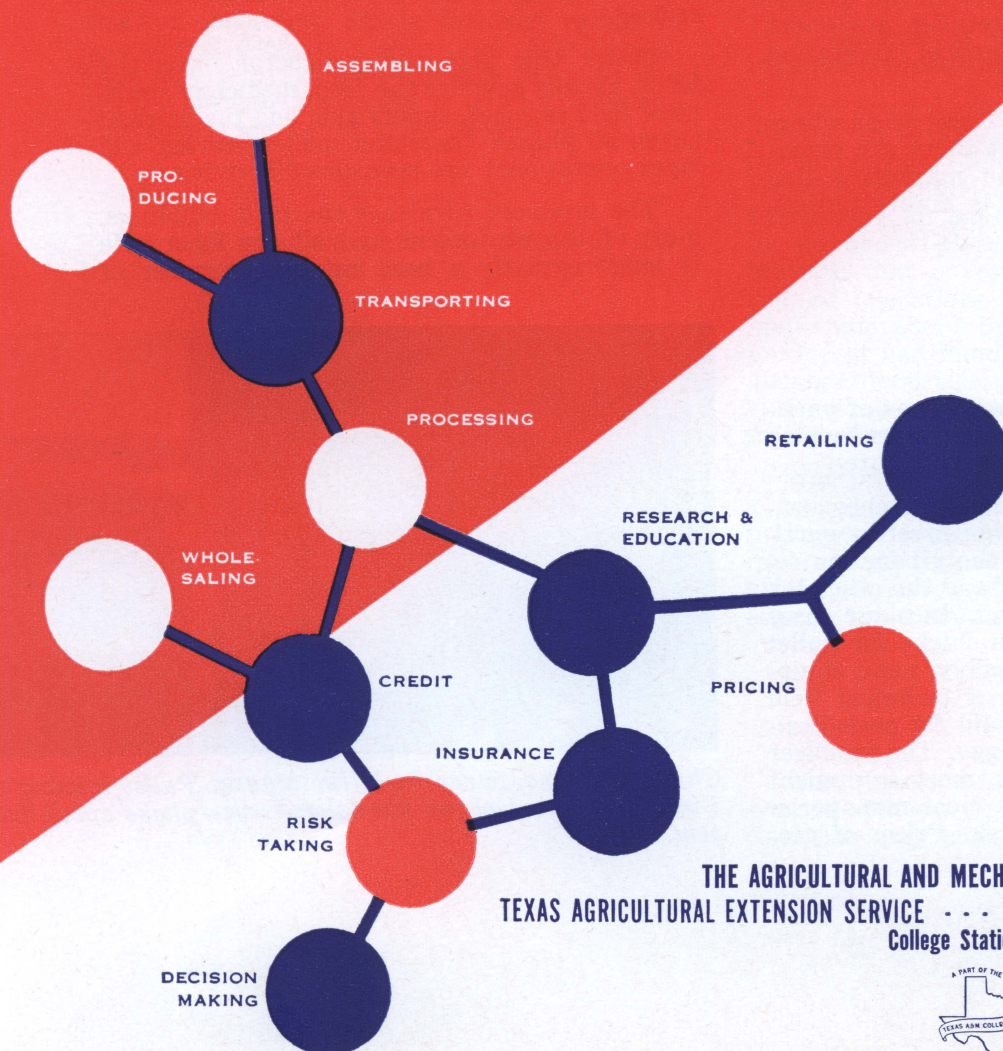
VERTICAL INTEGRATION IN TEXAS AGRICULTURE

Commercial Eggs



VERTICAL INTEGRATION in commercial table egg production and marketing is receiving widespread attention. Some anxiety exists about its possible results. Underlying this attention are discriminating consumers whose quality, quantity and delivery demands are concentrated increasingly volume-wise in the retail market. Such demands may mean adjusting the arrangements under which table eggs are produced and marketed. The positions of both the supplier, producer and wholesale buyer depend upon their practices and arrangements.

The adequacy of any system used in the resource supply, and egg production and marketing depends upon arrangements regarding division of profits among all segments of the industry. Each segment is confronted with new demands growing out of change - technology and consumer performance.



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Extent in the U. S. and Texas

Ten to 15 percent of the table eggs produced in the U. S. are handled under contract. The arrangements used vary widely, with most vertical integration revolving around feed and egg dealers as the "integrators." Most integration has been around big city markets in the East and the West, but contracts have been used recently in the Midwest and South. The Midwest is the chief table egg exporting region in the nation.

With increasing population and ample labor in the South, enterprising persons and firms in the industry have developed various types of egg production and marketing plans. Some are in areas where table egg production is relatively recent, and the industry is on a specialized commercial basis.

Changes in the production and marketing of table eggs in Texas are being made rapidly. A lower proportion of the State's eggs are produced and marketed under contract than in some areas of the U. S. However, in the "chain" from the producer to the retailer are short segments over which some vertical integration generally exists.

There are no well-defined Texas areas where integration predominates, but there are examples in the supply-production marketing line where the degree of control is highly formalized.

Types of Integrated Arrangements

Some of the more important types of vertically integrated arrangements under which table eggs are produced and marketed are:

Open account. The contracting agency usually is a feed dealer. This plan involves vertical integration over some of the production resources, egg production itself and the assembly of eggs. It may be contractual. In many cases the "integrator" finances the chicks for pullet rearing, feed, medicines, possibly some equipment and a certain amount of technical field services on "open account," paid for periodically. He may help market the eggs. The producer furnishes the land, buildings, most equipment and all the labor. He makes most managerial decisions and takes all the risk. Prices of pro-

duction resources and the product are whatever the market place develops.

This type of arrangement has certain advantages over the more independent operations in the past. It is used by more producers of table eggs for market in Texas than any other plan. The plan appears useful for the small-flock situation where such a geographic dispersal of producers exists. It lends itself to a less developed production and marketing situation. It may suffer loss of market opportunity by way of its looseness of vertical control.

Flat fee. Under this plan the relationships among suppliers of egg production resources, egg producers and egg wholesalers or retail establishments are more formal than the "open account" plan with contracts being used. The "contracting agency" may be a big supplier of table eggs to supermarkets, or a feed dealer who has a close relationship with wholesale or retail market outlets. Under this arrangement, the integrator maintains an active role in organizing and supervising production, and in marketing the product. A great deal of control is exercised.

Under this plan the contractor owns the birds, usually supplies the feed, medicines, technical field services, supervision and the market. Often all phases (hatching, pullet rearing and layer operations) are specialized activities.

The producer furnishes the land, buildings, most of the equipment and all the labor. He is paid regularly a base rate per number of

birds or dozen eggs with premiums for efficiency. Managerial decision-making and risk-bearing rest largely with the integrator. Negotiation is important in this plan. This arrangement is in the trial stage in Texas.

Guaranteed price. The "contracting agency" agrees to pay the producer a minimum price for Grade A or better quality eggs or a specified amount related to a particular market quotation. The contractor usually is a supplier of eggs to retail establishments. The producer may pay all costs including feed, pullets, drugs, labor, equipment, land and buildings. Under such a plan, contracting begins when the eggs are ready for market. A certain amount of the egg market risk is removed but the production risks and decision-making remain with the producer. Very little of this kind of operation exists in Texas.

Share plan. A plan of this type involves sharing both profit and loss, or sharing profit only. The costs are paid before distributing profits. Under this arrangement both parties must be in agreement over the whole range of production and marketing, and be involved equally in managerial decision-making and risk-bearing. They may contract with resource suppliers and market outlets. Financing is a joint program. This plan is not known to be used in Texas.

Future Developments

Vertical integration to the extent of contractual arrangements may well be a "must"

in the table egg industry of Texas. A number of factors seem to point to its possible growth. Primary pressure comes from the demands for concentration of consumer food buying and is influenced by a condition of "plenty" in all kinds of foods. A high degree of sensitivity in consumer choice prevails.

Among the more important specific factors fostering vertical integration in the table egg industry in Texas are:

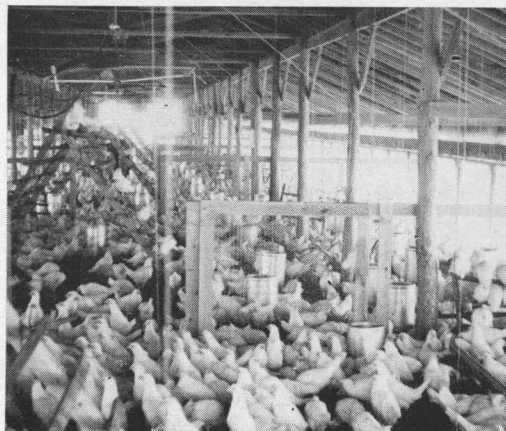
1. Amount of financing needed to operate at an optimum level of production—increasing labor and equipment costs.
2. Increased size of business required to yield a satisfactory level of income.
3. Range and complexity of technical and managerial knowledge required.
4. Extent of buying of production resources.
5. Narrow range of market tolerance in quality, quantity and delivery of eggs.
6. Competitive position of the wholesale egg buyer.
7. Geographic dispersal of layer flocks, and regional competition.

The crucial element in the application of vertical integration, especially contracting, in the commercial table egg industry seems to be a satisfactory division of responsibility and benefits among all parties involved. Regular trips by service people and for delivery of supplies indicate that a certain geographic concentration of operations should be developed. This may come about by realignment of the many producers and handlers, or have a few big producing enterprises. Volume production will provide for many economies of operation, and utilization of rapidly evolving technology.

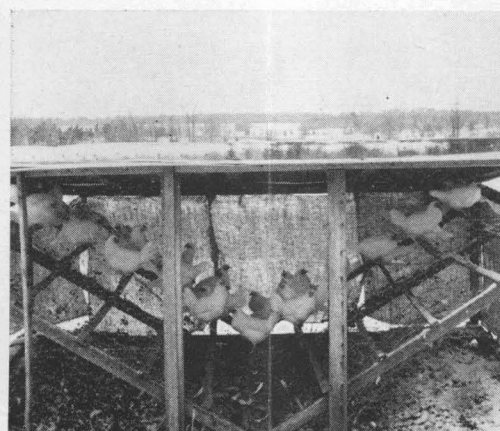
Egg producers are interested in maintaining a position of sharing the benefits due to improvement in their own management including risk-taking. Egg suppliers are interested in improving their competitive profit position by satisfying the consumer.

Evaluation of Vertical Integration

The objective of vertical integration is increased efficiency and reduction of costs. This condition may place Texas in a more competi-



Chick brooding phase in latter stages. First in a three-phase specialized system.



Pullet rearing phase. Second in a three-phase specialized system.



Layer phase. Last in a three-phase specialized system of commercial egg production.

tive position regionally. Many small producers can continue in business by making appropriate geographic and inter-producer adjustments. Producers with small volume and widely separated from each other geographically are hard pressed to attain necessary efficiencies and attract the markets.

The success of vertical integration depends upon:

1. Good enterprise organization and management of table egg production.
2. Early and regular adoption of improved practices.
3. Confidence of producers regarding integration with the resource suppliers and marketing segments of the industry.
4. Improvements in the grading and handling processes.
5. Prices that reflect supply and demand properly.
6. Plans for sharing profits resulting from improvements which producers and handlers develop together.

The trend toward larger commercial egg-producing units continues. This development will afford returns for a higher degree of management knowledge and skills in the production of eggs. A better understanding of what is required for more effective marketing of the product will enhance production operations. Vertical integration arrangements can provide effective egg quality control through the production and marketing phases that meet requirements of specification buying. Increased earnings in egg production likely will become strong investment alternatives open to the capital market.

The complexity within the production phase may be such that certain specialization will be found advisable, such as chick brooding, pullet rearing and egg production. Or, the producer may need help only in the assembly, grading, packaging and wholesaling phases. In this case, the producer may be willing to finance production and bear associated risks. A marketing agreement would assure the producer a stable market based upon quality and quantity of eggs delivered at a specified time with minimum effort.

Various arrangements under vertical integration cannot be compared directly since each type is designed for a particular purpose, such as variable proportioning of financial, manage-

rial and risk-bearing responsibilities. Therefore, profits should be distributed accordingly.

Cautions

A caution to long-time integrated commercial table egg arrangements is whether either party is in the arrangement as a marginal business venture. If it is as a marginal venture, one may expect a certain degree of instability in this realm of the parties' business, i. e., the joint decisions will be conditioned largely by their major business interests. There might be cases where extensive dependence is put on the arrangement by one party while the other party will "check out" anytime, especially if his interest is a marginal business interest.

Another caution is the situation where a premium price over the existing price for commercial table eggs may be offered by an egg dealer. The dealer may furnish some kind of production or marketing supply or service. The critical question for either party is: "What is the relationship of the value of the premium to the value added to the cost of the supply or service item?"

Since the parties concerned with contractual vertical integration in any part of the production-marketing process most likely will not be related in a partnership, the question of bargaining or negotiation is important. Each participant should understand fully the integration organization, its economics as well as its legal commitments before entering into such an agreement.

Vertical integration is the linking together of two or more stages of production, processing or marketing activities under one management. The key feature of vertical integration is the centralization of decision-making, risk-bearing and supervision.

This is the sixteenth leaflet in the series "Vertical Integration in Texas Agriculture."

By bringing together current knowledge and practices on vertical integration in Texas agriculture, the staffs of the Texas Agricultural Extension Service and Texas Agricultural Experiment Station in the Department of Agricultural Economics and Sociology hope to help you make wise decisions in this matter.

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